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Supreme Court of the United States

OCTOBER TERM, 1938

No. 968 56

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

THE F. AND R. LAZARUS AND COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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INTRODUCTION

References to the opinions below, the jurisdiction and the statute involved are set forth in the petition for writ of certiorari filed herein by petitioner (pages 1-3).

The Board of Tax Appeals found that it was not the intention of the taxpayer to make a sale, but that the transaction leading to the issuance of the land trust certificates was one of loan and that the conveyance was by way of

security. Therefore, the taxpayer remained the substantial owner of the property and was entitled to charge a fair depreciation on the improvements used in its business. We submit that this conclusion of the Board of Tax Appeals, supported as it is by substantial evidence, is binding on the courts. As to alleged conflict between the decision below and that of the Court of Appeals of the District of Columbia in *City National Bank Building Co.* v. *Helvering*, 98 F. (2d) 216, as will be shown later, there are such important differences of fact in these two cases, that they are not necessarily in conflict.

STATEMENT

The petitioner has set forth in his brief (pages 3-8, inclusive) the substantial facts, as set forth in the opinion of the Board of Tax Appeals, except that petitioner's brief omits the facts found on page 29 of the record, as follows:

> "From the undisputed testimony in the record it is clear that the petitioner's desire was to obtain a long-term loan on the security of its real property, with provision for reacquisition of unencumbered title. It was not interested in selling the property to raise the needed funds. The petitioner then considered the property conveyed to be worth around $6,000,000 and it would not have sold it for $3,250,000, the face amount of the trust certificates actually sold. The representative of the bank in the transaction testified that he did not consider that the bank was buying the property, and that the deal was merely one involving a loan with ample security. The bank had the property appraised to determine not whether the property was worth $3,250,000 to it as a buyer, but to establish the value of the land and improvements for loan purposes. The appraisal made by qualified appraisers established a value of $3,453,125 for the land and $3,056,427 for the improvements as of the time of the transaction.

"The transaction was carried out in the form described instead of by a mortgage loan because of the lack of a market at that time for mortgage notes. The annual rentals were fixed on the basis of a 5 per cent return on the face amount of the outstanding certificates, an amount established by evidence to be less than a fair rental. This the petitioner recognized by making a rent charge of $375,000 on its books each year for the property.* The option price of the property held in fee was fixed at an amount equal to the call price of the outstanding certificates and the amount of the quarterly payments into the depreciation fund is sufficient to retire all of the certificates within 48½ years at the call prices thereof. Up to this time the petitioner has been able to meet the requirements of the fund with certificates purchased in the open market at less than the call prices and now has on hand certificates of a face amount sufficient to meet its depreciation fund obligations for sixteen years. The petitioner desired to have the lease provide for a depreciation fund equal to the option price of the property, but it was limited to $2,600,000 in the lease in order to bring the transaction within a certain ruling of the Attorney General of Ohio.

"From a consideration of all the evidence we conclude that the deed given was in reality a mortgage, and that the transaction was not one in which the petitioner lost its right to deductions for exhaustion of the property conveyed."

Mr. Fred Lazarus, Jr., testified that he handled the finances of The F. & R. Lazarus & Company and had done so for twenty-seven years. He handled its financing in 1928, the year in which the transaction involved occurred. In that year the company had completed an addition to their Columbus building at a cost of $2,000,000, for which they had borrowed $1,700,000 on a ten (10) year mortgage at five per cent (5%) interest in 1926 from the North-

*The actual rental payable to the Trustee for land trust certificate holders was $162,500 a year, 5% of $3,250,000. (R. 27)

western Mutual Life Insurance Company (R. 45). In June, 1928, they purchased the controlling stock of The John Shillito Company (of Cincinnati) for slightly more than $500,000. This was financed by issuing short term notes that were sold to A. G. Becker & Company, an investment and banking house of Chicago, payable in six (6) months (R. 45). He said they had two propositions for long term financing, one from Becker for a bond issue and one from the Huntington National Bank of Columbus for a land trust certificate issue. They accepted the Huntington proposition because it was self-liquidating and the other proposition was not self-liquidating (R. 46). Under the Huntington proposition with the repayment of a fixed annual rental plus one-half of one per cent (½%) annually to the sinking fund, the principal of the loan would be liquidated in 48½ years. The representative of the Huntington National Bank, who was the manager of its bond department, had prepared a schedule showing how the liquidation would occur. This is attached to the narrative statement of evidence as "Petitioner's Exhibit No. 3" (R. 46 and 62).

Mr. Lazarus further testified that in June, 1928, he thought the land and buildings of The F. & R. Lazarus & Company in Columbus, which were made subject to the land trust certificate issue, were worth $6,000,000. He would not have sold the properties to the bank or anyone else at that time for approximately $3,250,000 (R. 48). These properties were appraised by three qualified appraisers as worth $6,509,552, as of June 13, 1928 (Testimony of Converse, R. 43; of Beggs, R. 53 bot.; of Vercoe, R. 55; Petitioner's Exhibit No. 1, R. 60).

On the basis of the testimony as found by the Board of Tax Appeals, it concluded that The F. & R. Lazarus & Company was entitled to take depreciation over a useful life of the buildings of fifty (50) years.

ARGUMENT

I.

Even if certiorari were granted, this Court would be bound to affirm the judgment of the Circuit Court of Appeals for the Sixth Circuit, as the finding of the Board of Tax Appeals in this case, supported as it is by substantial evidence, is conclusive

The question before the Board of Tax Appeals was whether the conveyance by respondent to the Huntington National Bank of Columbus, as Trustee, and the taking of the perpetual lease back, was in substance a conveyance away of respondent's interest, or was in substance and in equity a security transaction analogous to a mortgage. On this question of fact the finding of the Board of Tax Appeals was in favor of the respondent (R. 29-30).

In Ohio, where land is conveyed by an absolute deed and the vendee at the same time delivers to the vendor a contract by which he agrees to convey the premises by a specified time, upon the payment of the purchase money with interest, there is a presumption that the deed was intended as a mortgage and it will be so held in equity. *William Marshall* v. *Charles Stewart et al.*, 17 Oh. 356. See, also, *Coleman* v. *Miller*, 8 Oh. (Reprint) 179; *Cotterell* v. *Long*, 20 Oh. 464; *Helmbold* v. *Helmbold*, 25 Oh. App. 32.

This Court has held that an absolute conveyance, for the loan of money, may be shown to be and treated in equity as a mortgage. *Peugh* v. *Davis*, 96 U. S. 332. See, also, *Russell* v. *Southard*, 12 How. 139.

It is not necessary that the taxpayer be the holder of the legal title to property in order to be entitled to take depreciation as a deduction in its income tax return. *Duffy* v. *Central R. Co. of N. J.*, 268 U. S. 55, at page 64.

The intention of the parties in a transaction is a question of fact and the finding of the Board of Tax Appeals

thereon is conclusive on the Courts. *Colorado Bank* v. *Commissioner*, 305 U. S. 23.

Even where the evidence is undisputed, if different inferences might reasonably be drawn therefrom, the judgment of the Board of Tax Appeals will not be disturbed. *Johnson* v. *Commissioner*, 8 Cir., 88 F. (2d) 952.

II.

The asserted conflict between City National Bank Building Co. v. Helvering, 98 F. (2d) 216, and the decision below arises from differences of fact, and not in the application of any principle of law.

In the instant case, the taxpayer had constructed all the improvements in question before the transaction which gave rise to the question presented occurred. There was no change in operation or in the practical incidents of ownership from the day before the transaction occurred to the day after it occurred.

In the *City National Bank Building Co.* case the corporation involved had never had legal title to the property but was organized for the purpose of taking the leasehold, so that the land trust certificates and leasehold bonds might be issued. It was a transaction devised and entered into solely for the purpose of issuing securities. The Board of Tax Appeals, in deciding the *City National Bank Building Co.* case, after referring to its decision in the instant case and the decision of the Sixth Circuit Court of Appeals in *Commissioner* v. *Neighbors Realty Co.*, 6 Cir., 81 F. (2d) 173, stated: (34 B. T. A. 93, at page 99).

> "The facts in the present case are different in some respects from the facts in the *Lazarus* and *Neighbors* cases. It may be that these differences serve to distinguish the cases. The transactions in the *Lazarus* and *Neighbors* cases were initiated by existing corporations in order to refinance their indebtedness. Here

the transactions were initiated by bankers who desired some business."

The *Neighbors Realty Co.* case was one in which the Court held, following the Board of Tax Appeals, that no gain or loss resulted from the conveyance of the company's property to a trustee and the taking of a perpetual lease back, for the purpose of issuing land trust certificates, on the ground that the transaction was one for security only and the corporation was still the substantial owner of the property. This was in accordance with the ruling of a previous Commissioner in I. T. 2679 (Internal Revenue Cumulative Bulletin, XII-1, p. 103). It followed as a corollary that the corporation could take depreciation on the improvements on the property as a deduction in connection with its income tax return.

There are other important differences between the instant case and the *City National Bank Building Co.* case, in that there was a depreciation fund provided for (really an amortization fund) which was not provided for in the City National Bank Building Company lease. These differences, while not referred to as such, are set out in the following language of the Court of Appeals in the instant case, in 101 F. (2d), at page 730 (R. 176), as follows:

> "Here there was established a Depreciation Fund (really an amortization fund not to be confused with the depreciation on buildings for which the deduction was claimed) payable at a rate not less than $16,250.00 a quarter in cash or certificates, sufficient to amortize the indebtedness in 48½ years, but limited to a total accumulation of $2,600,000 to conform to a ruling of the Attorney General for the State of Ohio. At the date of the hearing before the Board the company had already acquired in open market sufficient certificates to pay sinking fund requirements for the next 16 years. . . .

"All of these facts: the long life of the Company; the fact that it had constructed the buildings to suit its own needs and was expanding its business in other communities; that it was setting out to liquidate the indebtedness through the Depreciation Fund and thus re-acquire title to the property; in addition to the authority of the Neighbors' case, to which we adhere, support our conclusion that no absolute conveyance was intended and that the Company did not lose its right to make deductions for exhaustion of property conveyed."

When it appears that the asserted conflict in decisions arises from differences in states of fact, and not in the application of a principle of law, a writ of certiorari has been dismissed as improvidently granted. *Wisconsin Electric Co.* v. *Dumore Co.*, 282 U. S. 813.

CONCLUSION

As there is here a finding of fact sustained by substantial evidence and as the alleged conflict of decisions is really one of fact rather than of law, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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June 5, 1939.